- *Smaller tenants have been active in 2021, but larger groups remain slow*
- *112,000sqm of new supply is under construction with a strong pipeline*
- *Sales volume remains low but should pick up off the back of CBD activity*

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Brisbane Near City Office

Market Report, June 2021

SUPPLY UPLIFT TO ENABLE NEW WORKPLACE DESIGN

With office demand set to react to tenant requirements for new workplace design, greater wellness facilities and collaboration space, the uplift of new supply in the Near City will facilitate this

16.6%
VACANCY

112,000SQM
currently under construction

$665
MILLION SOLD 2020

"Tenant demand in the sub-500sqm tranche has increased through 2021; nevertheless the level of prime sub-lease and new supply under construction has softened effective rents."

The Key Insights

Net absorption was strongly negative in H2 2020, mostly through corporate contraction and sub-lease space. However 2021 has seen more positive activity, largely from SME operators to make decisions and take space in the Near City.

Prime and secondary gross effective rents have fallen by 10.4% and 5.6% respectively since the onset of COVID-19. The majority of this has come from increased incentives. Prime effective rents will stabilise late 2021.

Large tenant activity has remained subdued, although to date there has been a clear preference for prime buildings with good quality existing fitout. This has seen some of the sub-lease space absorbed in recent months.

Investment turnover was lower in 2020 in the Near City market, however it did not drop to the extent seen in the CBD with two large-scale sales buoying turnover. In 2021 transactions have been slower to build momentum.

Brisbane Near City Office Market Indicators—April 2021

GRADE	TOTAL STOCK SQM^	VACANCY RATE %^	ANNUAL NET ABSORPTION SQM^	ANNUAL NET ADDITIONS SQM^	AVERAGE GROSS FACE RENT $/SQM	AVERAGE INCENTIVE %	EFFECTIVE RENTAL GROWTH % YOY (gross)	AVERAGE CORE MARKET YIELD %*
Prime	609,722	13.4	-18,513	-	580	41.5	-7.2%	5.83%
Secondary	613,592	19.7	-16,734	-785	470	40	-4.1%	7.15%
Total	**1,223,314**	**16.6**	**-35,247**	**-785**				

Source: Knight Frank Research/PCA ^ as at I January 2021 PCA Data *assuming WALE 5.0 years

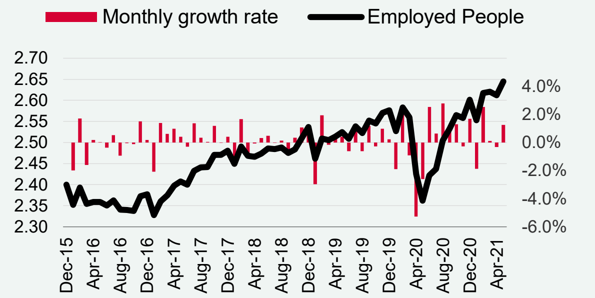
DEMAND DOMINATED BY SMALLER TENANTS

The economic recovery continues to outperform initial expectations

The economic and labour market recovery has exceeded all expectations with economic output back above pre-COVID-19 levels in the Q1 2021 GDP figures, far ahead of initial expectations which were as far out as Q1 2022. The June 2021 NAB Business Conditions survey returned a record high of +37 points, up +5 points over April which itself was a record result. This indicates that the unprecedented Federal government financial support and monetary policy stimulus has seen economic activity strongly supported through the lockdowns and pandemic interruptions. While the JobKeeper payment ended on March 27th, momentum in the economy has appeared to be maintained in the weeks since. In Queensland, the number of people employed exceeded February 2020 levels during December 2020, after falling by 8.4% during March – May 2020. In 2021 employed persons have increased further with an additional 43,820 jobs added.

Queensland - Total Employment

millions employed (LHS), Monthly growth rate (RHS)



Source: Knight Frank Research, ABS 6202

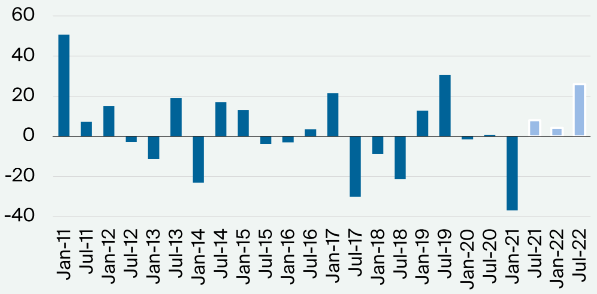
Net absorption to be boosted by whole of building tenants moving into the Near City market

The Near City office demand was initially harder hit than the CBD with a higher concentration of travel exposed companies (Flight Centre, Virgin Australia) and industries which to date have adopted work from home practices during COVID-19 such as engineering and other consulting services. This resulted in negative net absorption of –36,849sqm in H2 2020.

In the short term, whole building tenants such as Mater Group and ATO moving into the Near City will boost net absorption figures. Sustained SME activity will also put a positive trend on net absorption until corporate activity catches up. The sustained new supply is also expected to support higher Near City net absorption across the medium term as tenants are consistently drawn to new space, particularly where rental levels for new buildings are in line with a tenant's existing rent at the end of the lease term.

Brisbane Near City Net Absorption

'000 square metres



Source: Knight Frank Research, PCA

Recent significant tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	FACE RENT $/ SQM	INCENTIVE	TERM YRS	START DATE
QUU	31 Duncan St	UR	6,015	705	u/d	10	PC
Mater Group*	14 Stratton St	UR	9,088	650	u/d	10	Jul 21
Clough	825 Ann St ^	UR	1,648	625	40%~	6	Jul 21
KBR	100 Brookes St ^	UR	1,752	625	40%~	5	Mar 21
Ausenco	189 Grey St ^	IS	2,300	635	40%+	5	Mar 21
Northrop Grumman	100 Brookes St ^	UR	1,739	625	40%~	5	Jan 21
Golding Contractors	40-52 McDougall St	Milton	2,152	495	40-45	8	Sep 20

* vendor leaseback ^space had been marketed for sub-lease although new direct deals agreed ~existing high quality fitout

POTENTIAL SUPPLY IS PLENTIFUL

Six projects covering 112,000sqm currently under construction in the Near City

Construction in the Near City market has increased over the past 18 months with both speculative and pre-commitment driven projects commencing. The next to complete, in the coming months, is 14 Stratton St, Newstead. The 8,069sqm building began as a speculative development, however is now fully committed to the Mater Group which has sold the property on a 10 year vendor leaseback.

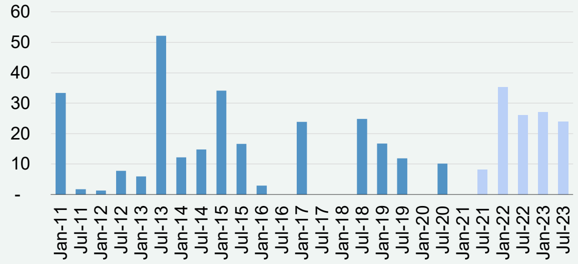
Due to complete at the end of 2021 is the 42% committed (Watpac & Spaces) Jubilee Place development in Bowen Hills and the speculatively constructed Mobo at South Brisbane. 152 Wharf St remains on track to be finished by mid-2022 with ATO workers to relocate from Chermside and also overflow demand from 55 Elizabeth St, CBD to fill the fully committed tower. 2023 completions will entail the currently c30% pre-committed 31 Duncan St and the speculatively developed 895 Ann St, both in Fortitude Valley.

Any further starts in the medium term will be triggered by pre-commitment

Given that almost 60% of the space currently under construction is presently not committed, any further construction starts are expected to occur on a more risk sensitive basis. There are 11 major projects with development approval awaiting pre-commitments to begin and a further three projects seeking development approval. More than three -quarters of potential future projects are located in the Urban Renewal precinct which will keep competition between those projects high. The relatively limited projects in other Near City areas have a greater point of difference to offer tenants.

Brisbane Near City Supply Additions

'000 square metres



Source: Knight Frank Research, PCA

SUPPLY

CONSTRUCTION:

14 Stratton St, Newstead (UR) –8,069sqm
100% committed to Mater Group July 2021

470 St Paul's Tce, Bowen Hills (UR) –17,544sqm
42% committed December 2021

134 Merivale St, South Brisbane (IS) –17,800sqm
December 2021

152 Wharf St, Spring Hill (SH) –24,000sqm
100% committed ATO H1 2022

31 Duncan St, Fortitude Valley (UR) –21,000sqm
29% committed Urban Utilities H1 2023

895 Ann St, Fortitude Valley (UR) –24,000sqm
Mid-2023

DEVELOPMENT APPROVAL:

358 Wickham St, Fortitude Valley (UR) - 22,114sqm

458 Wickham St, Fortitude Valley (UR) - 8,236sqm

The Aviary Toowong (T) - 24,265sqm

52 Alfred St, Fortitude Valley (UR) - 32,693sqm

301 Wickham St, Fortitude Valley (UR) - 35,000sqm

The Greenhouse, West Village (IS) - 7,121sqm

6 Little Cribb St, Milton (M) - 29,870sqm

21-25 Morgan St, Fortitude Valley (UR) - 18,825sqm

426-442 St Paul's Tce, Fortitude Valley (UR) - c40,000sqm

525 Boundary St, Spring Hill (SH) - 5,484sqm (medical)

41-47 Brookes St, Fortitude Valley (UR) - 14,964sqm

DEVELOPMENT APPLICATION:

160-180 Breakfast Creek Rd, Newstead (UR) - 18,910sqm

251 Wickham St, Fortitude Valley (UR) - 15,882sqm

58 Morgan St, Fortitude Valley (UR) - 13.270sqm

MOOTED:

One West Village, West End (IS) - c20,000sqm

K3, King St, Bowen Hills (UR) - c25,000sqm

Projects 5,000sqm+. Excludes abandoned schemes, however not all of the above are actively marketing at this time.
UR–Urban Renewal, IS–Inner South, M–Milton, T–Toowong, SH–Spring Hill

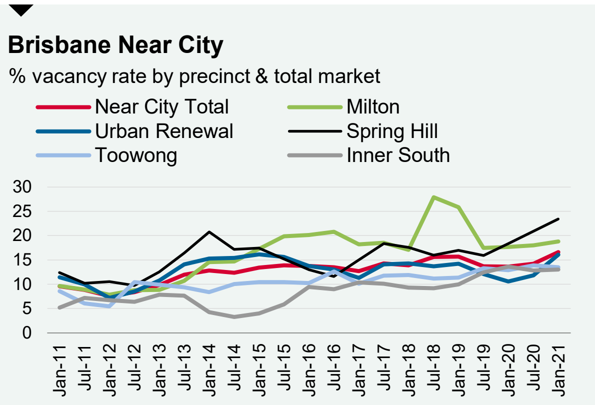
EFFECTIVE RENTS SOFTER AS VACANCY HIGH

Vacancy to remain elevated due to sustained new supply additions in the next three years

Total vacancy reached a record high of 16.6% in January 2021 as the negative net absorption of late 2020 impacted the market. Total vacancy is expected to remain relatively stable to mid-year with mostly SME tenant activity and no un-committed new supply coming on-line. While there remains significant sub-lease space offered for lease the large influx of 2020 is not expected to be repeated.

Aside from the boost given to net absorption from 14 Stratton St, the uplift will be modest with decision making only ramping from Q1. Tenant mobility will increase over time, particularly where new fitout designs are incorporated to support changing workplace practices. Net absorption will be supported by take-up in newly constructed buildings with the potential for tenants to relocate into the Near City from CBD or suburban locations as occurred during the last supply surge 2007-2010. In the medium term the total vacancy is expected to remain elevated between 17% and 18% through 2022 and 2023 before showing some moderation as supply completions slow from 2024.

Prime vacancy was sitting at 13.4% as at January 2021 (PCA) with 10.3% direct and 3.1% sub-lease vacancy. To mid-year the prime vacancy is expected to be stable or show slight improvement. Sub-lease space, particularly with good existing fitout, tends to lease first and some sub-lease space has now been taken up or re-occupied and withdrawn from the market. From late 2021, however, prime vacancy is expected to increase as the uncommitted supply impacts on the market.



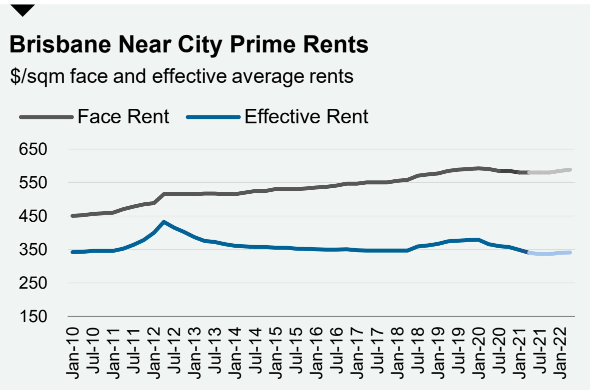
Source: Knight Frank Research, PCA

Prime effective rents have fallen by 7.2% in the past 12 months and will remain soft during 2021

Prime effective rents have softened over the past 12 months, falling by 7.2% in the year to April 21 and 10.4% below the levels of January 2020, reflecting the COVID-19 impact. The falls arise from higher incentives rather than through face rent reductions. Average prime incentives are currently 41.50% but will be 42% by the end of 2021. As with the CBD market 'soft incentives' such as extended lease start date, removed or reduced make goods and lessor's works are common and would take many deals above 45%. Average prime incentives were 36% at the start of 2020 and have increased by 550bps since then. Incentives for newly constructed or pre-commitment space are significantly higher.

Effective rents are forecast to slightly soften further through mid-late 2021 before stabilising and showing some improvement in 2022. The quantum of sub-lease space competing in the prime market has heightened competition and will take some time to unwind. In the longer term, as the Near City will have an ever-growing supply of prime stock it will continue to provide competition to the CBD, with prime effective rental growth 2.5%-4.5% per annum from 2023+.

Secondary rents have also softened from a low base, however with the economic resilience and greater activity from smaller tenants the falls are not to the same extent as for the prime market. Gross effective rents have fallen by 4.1% in the past 12 months and 5.6% since COVID-19 onset. Incentives have increased to 40% on average, however given a higher concentration of private ownership in the secondary market, not all owners can fund high incentives and will instead adjust face rents.



Source: Knight Frank Research

NEW BUILDS DOMINATING INVESTMENT

Turnover levels remain subdued with the 2020 volume coming from a small number of large sales

Transaction activity in the Brisbane Near City was subdued during 2020 with $665 million in transactions across the year. This was 15% lower than the level of activity during 2019 and the third consecutive year that turnover has declined since the recent peak levels of $1.1 billion in 2017.

However compared to the CBD market, the drop in transaction activity in the Fringe was relatively minor as transaction turnover fell by 76% in CBD between 2019 and 2020. In contrast again, the CBD market rebounded strongly in Q4 2020 and into 2021 with more completed transactions and more assets formally marketed, however the Fringe has not as yet seen this level of pickup in activity.

The 2020 sales activity in the Fringe was dominated by two transactions, which accounted for more than half of the turnover. The largest was the site sale and development agreement for 895 Ann Street, Fortitude Valley to DWS Group at an estimated $260 million. The completed asset will be delivered by Consolidated Properties. The other was the sale of 14 Stratton St, Newstead for $122.5 million to Charter Hall Social Infrastructure REIT. The asset, now in the final months of construction, was sold with a 10 year leaseback at a yield of 4.8%.That both these sales were of buildings either prior to construction start or under construction is a reflection of the market's preference for new core stock in the Fringe market.

Modern assets an attractive investment for both local and offshore buyers

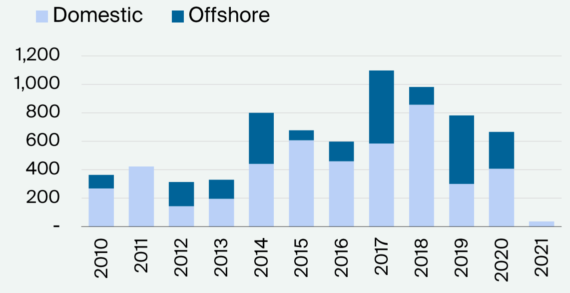
The level of turnover in the Fringe market is expected to accelerate over the course of 2021, off the back of greater investment activity in the CBD market and limited on-market offerings across both markets. After the confidence shocks of COVID-19 investment flows into office assets have been increasing—first into Gateway cities and then further to major capitals and equally from CBD markets to broader fringe and suburban markets across Australia.

While there is no doubt that office assets now face greater competition for investment from the industrial sector, the reducing allocation into retail investment is assisting office to maintain allocation levels. The overall positive funds flow into Australia has also kept competition high between buyers across assets and maintained the high level of off-market offers and transaction activity.

While the surge in supply over the next two years and potentially beyond is providing challenges for tenant retention in existing assets it also offers a host of new investment opportunities for buyers not yet represented in the Brisbane Fringe market. Prime, modern assets of scale will continue to be sought in the Near City market despite the recent softening of effective rents due to the higher income returns possible and the greater market diversification that investment in the Brisbane Near City provides.

Brisbane Near City Office Sales $10m+

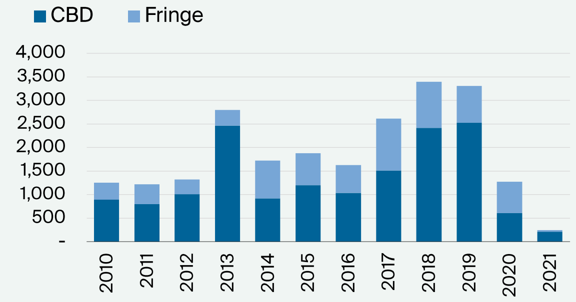
$m by purchaser location, 2021=ytd



Source: Knight Frank Research

Brisbane CBD & Near City Sales $10m+

$m office sales by market, 2021=ytd



Source: Knight Frank Research

Yields regained a tightening bias as the market reacts to the weight of funds seeking investment, particularly for modern assets

While relatively few assets of scale have recently transacted in the Near City market those sales do reflect a firming of yields, as is in force across the majority of major investment classes. Uncertainty saw yields stall in early 2020 until traction returned to global investment flows through Q3 & Q4 2020. Across the Brisbane markets there has been greater penetration from local buyers than offshore during 2020 as travel restrictions and risk aversion did lower offshore activity at the height of the pandemic.

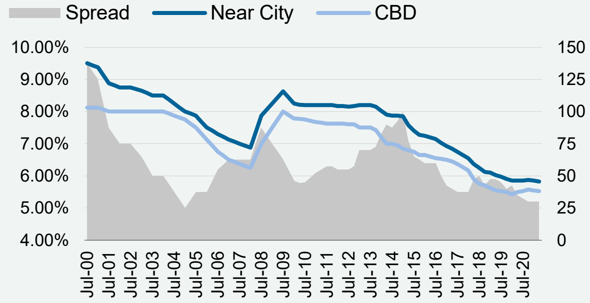
Prime yields in the Near City currently range between 5.15% - 6.50% for an established asset with a WALE c5 years. The median of 5.83% is 30bps above the median for the CBD as the markets continue to become more closely priced, particularly for larger scale Near City assets. Smaller assets with leasing exposure will be judged more harshly, toward the upper range, keeping the yield band broad.

The sustained expansive monetary policy settings for the cash rate and 3 year bonds have kept funding costs low. The recent stabilisation of both the Aust (1.48%—1.74% since 1 April 21) and US (1.50—1.74% since 1 April 21) 10y treasury yields has calmed debt market uncertainties that emerged during March. However inflationary pressures beyond the short term will be closely watched and a return to more normal money market activity will eventually put a floor under yields. Near City yields currently have a have a 414 basis points gap to the risk free bond yield, only slightly lower than the 10 year average of 443 bps.

"CBD and large-scale Near City assets continue to be more closely priced as the demand for modern assets of scale continues to blur the pricing between market precincts"

Near City v CBD Prime office yields

median yields (LHS), bps gap (RHS)



Source: Knight Frank Research

Recent significant sales

PROPERTY	PRICE $M	CORE MARKET YIELD %	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
33 Longland St, Newstead	20.33	6.56	2,936	6,923	1.7	Corval	Private Investor	Mar 21
37 Kennigo St, Spring Hill	15.80	6.60	2,955	5,347	1.1	Rifici Group	MADAD Property	Feb 21
2 Burke St, South Brisbane	80.20	5.46	8,637	9,286	7.2	Elanor Investors–Burke St Fund	Private Investor	Dec 20
88 Jephson St, Toowong	25.15	8.58	6,441	3,905	1.9	Private Investor	State Development Corp	Nov 20
14 Stratton St, Newstead	122.50	4.45	9,088	13,479	10.0	Charter Hall Social Infrastructure REIT	Mater Group	Oct 20
895 Ann St, Fortitude Valley#	260.00 est	n/a	24,000	10,833	-	DWS Group	Consolidated Properties	Sep 20

#site sold by Edenbridge Pty Ltd for $17.1 m, Consolidated Properties to deliver the building under a development agreement, not a typical fund through but included as a major capital deployment

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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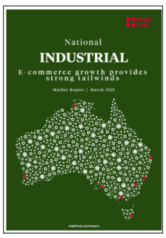

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